

CITY AUDITOR'S OFFICE

Collection of Delinquent Funds

May 8, 2009

AUDIT REPORT NO. 0906

CITY COUNCIL

Mayor W.J. "Jim" Lane Vice Mayor Ron McCullagh Lisa Borowsky Wayne Ecton Suzanne Klapp Robert Littlefield Tony Nelssen



May 8, 2009

CITY AUDITOR

Your Honor and Members of the City Council:

Enclosed is a report of *Collection of Delinquent Funds*, Audit No. 0906.

Various departments within the City pursue the collection of delinquent funds owed to the City. This audit focused on three active collection programs managed by: the City Court, Revenue Recovery (a division of Financial Services), and the Scottsdale Airport.

Areas for improvement, identified as a result of this audit, include: updating and adhering to stated policies and procedures, analysis of alternative service delivery options, adherence to City Code and state statutes, and establishment of verifiable performance measures.

We would like to thank City Court, Financial Services, and Airport staff for their cooperation and assistance during this audit.

The audit was conducted by Assistant City Auditor Lisa Gurtler.

If you need additional information or have any questions, please contact me at (480) 312-7756.

Sincerely,

City of Scottsdale

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Brent Stockwell Acting City Auditor

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EXECUTIVE SUMMARY

An audit of the Collection of Delinquent Funds was included on the City Council-approved fiscal year (FY) 08/09 Audit Plan. The objectives of this audit were to:

- 1. Verify compliance with stated policies, procedures, and applicable laws.
- 2. Ensure that steps are taken to properly record the City's Accounts Receivable balance and the write off of past due or delinquent funds.
- 3. Assess control activities and performance measures to ensure collection program objectives are met.
- 4. Assess and compare the effectiveness of selected collection programs.

The audit focused on three City collection programs: (1) criminal and civil fines and fees imposed and managed by the Scottsdale City Court, (2) utility billings and transaction privilege (sales) taxes managed by Revenue Recovery (a division of Financial Services), and (3) aviation related fees imposed and managed by the Scottsdale Airport (a division of Transportation). We reviewed collection activities applicable to fiscal years 06/07 and 07/08. Collectively, these areas make up 58 percent or \$42.0 million of the City's Accounts Receivable reported in FY 06/07 and 47 percent or \$42.2 million in FY 07/08.

We conducted tests on selected samples of transactions and activities designed to meet the objectives of this audit. In each of the three areas audited, we found that a control structure was in place, but could be strengthened to provide greater assurance of compliance or timely detection of noncompliance. The following areas for improvement were identified and are discussed in the Findings and Analysis section and included in the Action Plan at the end of this report.

1. Scottsdale City Court

- The reported accounts receivable balance was erroneously understated by \$1.4 million in FY 06/07 (see page 27).
- The Court's automated system did not identify some cases eligible for suspension per judicial order (see page 27).
- Management did not update documented procedures to be consistent with stated practices (see page 28).
- Management did not establish performance measures to assess contractor performance (see page 29).

2. Revenue Recovery

 Additional delinquent taxes could be collected if previously written off accounts were referred to a collection agency as allowed by City Code (see page 29).

- The collection agency contract was not updated for 16 years (see page 30).
- No recent formal evaluation of alternative service delivery for collection efforts was performed as required by Council-approved financial policy (see page 30).
- The annual write off percentage was not calculated as stated in Council-approved financial policy, and in two instances management was unaware of either the requirement to write off delinquent accounts or that accounts had been written off. (see page 32).
- Documented procedures were conflicting, and stated collection activities were not consistently applied (see page 33).
- Issuance and filing of liens, and assessment of late penalties applicable to delinquent utility accounts, do not comply with Arizona Revised Statutes (see page 34).
- Lien documents incorrectly stated the amount of interest assessed to the delinquent account (see page 35).
- Late fees are not applied to all delinquent utility accounts as required by City Code (see page 35).
- Reported performance measures were unverifiable and conflicting regarding the dollars collected for every dollar spent (see page 35).

3. Scottsdale Airport

- Management did not sufficiently document procedures applicable to key collection activities (see page 37).
- Interest was not assessed through the date of final payment as stated in City Code (see page 38).
- Management did not establish performance measures to assess program performance (see page 38).

BACKGROUND

Accounts Receivable

The Financial Services department is responsible for reporting the City's Accounts Receivable which is reflected in the Comprehensive Annual Financial Report (CAFR). Each City department that is owed money is responsible for developing efficient and reasonable collection procedures that will ensure timely payment of the receivable. Additionally, individual departments are responsible for ensuring that City Code and state statute mandated penalties are applied to those receivable accounts which have become past due or delinquent.

For purposes of this audit, accounts receivable is defined as a monetary claim against an individual or entity for money owed to the City. According to the FY 07/08 CAFR, the City's total reported Accounts Receivable balance was \$89.4 million, up \$16.8 million from the prior fiscal year. The reported balance changes daily as new accounts are added and paid accounts are removed.

The audit focused on three City collection programs: (1) criminal and civil fines and fees imposed and managed by the Scottsdale City Court (Court), (2) utility billings and transaction privilege (sales) taxes managed by Revenue Recovery (a division of Financial Services), and (3) aviation related fees imposed and managed by the Scottsdale Airport (a division of Transportation). We reviewed collection activities applicable to fiscal years 06/07 and 07/08. Collectively, these areas make up 58 percent of the City's Accounts Receivable reported in FY 06/07 and 47 percent in FY 07/08.

As depicted in Table 1, the City's largest reported receivables balance in FY 07/08 is Court fines and fees at \$28.0 million, followed by utility billings at \$18.2 million and transaction privilege (sales) taxes at \$13.1 million. While the Airport's total accounts receivable is relatively low at \$1.2 million, they, along with the Court and Revenue Recovery, have an active collection program and as such were included in the audit. Other accounts receivable reflected in the CAFR include State Shared Sales Taxes, Special Assessments, Franchise Fees, and Interest. These other accounts receivable generally have a low risk of becoming delinquent.

Table 1. Accounts Receivable As of June 30, Fiscal Years 06/07 and 07/08 (in thousands of dollars)

	FY 06/07	% to Total	FY 07/08	% to Total
(1) Court Fines and Fees (a)	\$24,081	32%	\$28,023	31%
Allowance for				
Uncollectibles (a)	(15,300)	-21%	(18,335)	-21%
Subtotal	\$8,781	12%	\$9,688	11%
(2) Revenue Recovery				
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Utilities	\$18,586	26%	\$18,189	20%
Privilege Tax	14,339	20%	13,132	15%
Subtotal	\$32,925	45%	\$31,321	35%
(3) Airport	287	0%	1,155	1%
Subtotal	\$41,993	58%	\$42,164	47%
All Other (State Shared				
•				
Sales Taxes, Special				
Assessments, Franchise				
Fees, and Interest)	30,595	42%	47,269	53%
Total Accounts				
Receivable	\$72,588	100%	\$89,433	100%

⁽a) The CAFR for FY 06/07 originally reflected Court Fines and Fees of \$22.7M and Allowance for Uncollectibles of \$(14.9M). These amounts were restated by Court management due to a reporting error (see page 27).

SOURCE: Auditor analysis of City of Scottsdale CAFR, fiscal years 06/07 and 07/08 and restated Court reports.

Delinguent Accounts Receivable

Although an account has been recorded as a receivable, it is not necessarily delinquent. A delinquent account is defined as an account for which payment has not been received by the specified due date. These delinquent accounts are pursued through the City's various collection programs.

The delinquent portion of the accounts receivable portfolio for each area audited is reflected in Table 2. Based on this information, 100 percent or \$28.0 million of the Court's total FY 07/08 Accounts Receivable was delinquent as of June 30, 2008. This is because all fines and fees are due on the date of sentencing. Collection activities begin within one to three days of nonpayment. For purposes of this audit, utility billings, transaction privilege (sales) taxes, and Airport billings are considered delinquent when late payment penalties are applied and/or collection activities begin which is approximately 30 days after the initial billing. As a result, only 10 percent or \$3.0 million of the total Revenue Recovery Accounts Receivable portfolio was considered delinquent and only 5 percent, or \$63,000, was considered delinquent for the Airport.

Table 2. Delinquent Accounts Receivable Portfolio Scottsdale City Court, Revenue Recovery, and Scottsdale Airport As of June 30, Fiscal Years 06/07 and 07/08 (in thousands of dollars)

_	Co	urt	Revenue	Recovery	Airp	ort
_	FY 06/07	FY 07/08	FY 06/07	FY 07/08	FY 06/07	FY 07/08
Delinquent Accounts Receivable (a)	\$24,081	\$28,023	\$2,844	\$2,987	\$92	\$63
% to total Accounts Receivable	100%	100%	9%	10%	32%	5%
No. of delinquent accounts	36,524	42,504	19,576	11,309	276	409

⁽a) The Court amount shown for FY 06/07 was originally reported as \$22.7M in the CAFR. This amount has since been revised by Court management to \$24.1M due to a reporting error (see page 27).

SOURCE: Auditor analysis of fiscal year-end receivable reports provided by the Court, Revenue Recovery, and Airport management.

Uncollectible Accounts

In addition to recording the City's Accounts Receivable, Financial Services staff is responsible for reporting annual write offs and an estimate of uncollectible accounts. A write off is an actual reduction to the accounts receivable general ledger account. An estimate of uncollectible accounts, referred to as the Allowance for Uncollectibles, is subtracted from the accounts receivable balance to determine the net accounts receivable balance. In effect, both a write off and an allowance for uncollectible reduce the accounts receivable balance to ensure that the City is not overstating its receivables for financial reporting purposes.

Whether deemed a write off or an allowance for uncollectible, the amounts provided to Financial Services staff are based on the age of the account, historical trends, and other pertinent data. The City Court reports an annual Allowance for Uncollectibles, as is the common practice of Arizona courts. The other areas of the City that have a collection program generally report write offs.

The Financial Services General Manager approves the City's annual write off amount based on information provided in a memo prepared by the Revenue Recovery Manager. This memo depicts detailed write off account information that was either identified by Revenue Recovery or was provided by the Accounting Division of Financial Services, based on information received from the various departments.

The amount of the City's annual write off was \$1.3 million in FY 06/07 and \$1.0 million in FY 07/08. The reported Allowance for Uncollectibles, based on City Court information provided to Accounting staff, was \$15.3 million¹ in FY 06/07 and \$18.3 million in FY 07/08. The Allowance for Uncollectibles is a cumulative amount meaning that the Court increased its previously reported FY 06/07 estimate of \$15.3 million by an additional \$3 million to derive the FY 07/08 estimate of \$18.3 million.

Below are the three collection programs included in this audit: Scottsdale City Court, Revenue Recovery, and the Airport.

Scottsdale City Court

Scottsdale City Court is a limited jurisdiction court; as such, the Court hears misdemeanor criminal and civil traffic cases, photo enforcement and parking violations, and violations of City Code. In FY 07/08, the Court heard more than 198,000 cases; approximately 75 percent of those cases were civil traffic. Defendants who have made a plea or who have been found guilty or responsible for a violation are obligated to pay the Court ordered fine or fee on the date of sentencing. All Court ordered fines or fees are recorded as an accounts receivable.

The Court's collection program is primarily performed by Court Service Representatives within the Public Service and Court Finance area under the direction of a Deputy Court Administrator as reflected in Chart 1.

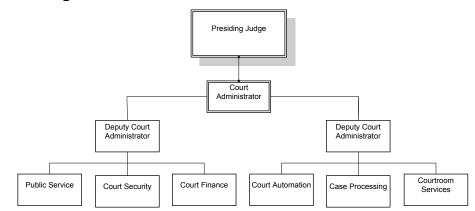


Chart 1. Organizational Chart

SOURCE: Auditor analysis of organizational chart provided by Court management.

Due to the Court's automated collection activities and use of an outside collection agency, only 1.2 of the Court's FY 07/08 budgeted full-time equivalent (FTE) staff of 66.1 is utilized for collection activities. The Court's budget includes one Revenue Collector position; however, based on the Court's operational needs, this position has been utilized as a Senior Court Service Representative.

¹ The FY 06/07 Allowance for Uncollectibles was originally reported as \$14.9M. This amount was subsequently revised to \$15.3M by Court management due to a reporting error (see page 27).

Court Assessed Fines and Fees

If the defendant is unable to pay their fine in full on the day of sentencing, the defendant can be placed on a payment plan for a fee of \$20 as mandated by Arizona Revised Statute (ARS) §12-116. To be considered for a payment plan, the defendant is required to complete an application designed to determine their ability to pay. Payment plans require a 50 percent down payment; final payments are due within 90 days. If the defendant requests additional time, a new payment plan can be created provided the defendant has a reasonable payment history.

Failure to pay in full on the date of sentencing or to comply with the terms of the payment plan will result in the following progressive actions. Each action is fully automated using the Court's case management system, AZTEC WIZARD TM .

- 1. Issuance of a nonpayment fine review letter. Within three days of the violated payment terms or date of sentencing, civil cases are assessed an additional \$25 fee per charge and the defendant's driver license is suspended. Criminal cases are assigned a future court date; failure to appear will result in the issuance of a warrant.
- 2. Issuance of a pre-collection letter. Within 18 days of the violated payment terms or date of sentencing, a letter is sent advising of pending referral to a collection agency.
- 3. Assessment of a collection fee and referral to the Court's collection agency. If no payment is made (or revised payment terms established) within two weeks of the mailed pre-collection letter, a collection agency fee of 25 percent is assessed on the outstanding delinquent balance. Per City Code Sec. 9-8.1, the cost of the collection agency is passed to the defendant. The City incurs no cost for this outside collection service.

In addition, all cases with a balance due, regardless if on a payment plan, are submitted to the Arizona Department of Revenue's Debt Setoff Program for possible state tax refund interception. ARS §42-1122 allows all Arizona courts to participate in this program.

Approximately 88 percent of the Court's delinquent accounts receivable portfolio is referred to the collection agency. All collected funds, including the agency fee, are remitted to the Court. Monthly, the collection agency submits an invoice to the Court for services rendered. Through the Court's internal efforts and partnership with the collection agency, over \$2.7 million was collected in FY 06/07 and \$3.3 million in FY 07/08. The remaining 12 percent of the Court's delinquent accounts receivable portfolio is either on a payment plan, ineligible for collections (e.g., appeals, bankruptcy), or is currently being worked by Court staff.

Table 3 depicts the Court's aged delinquent accounts receivable portfolio as of June 30 for fiscal years 06/07 and 07/08. The Court's delinquent portfolio totaled \$24.1 million in FY 06/07 and \$28.0 million in FY 07/08. Of this amount, more than \$10 million has been delinquent for over four years.

Table 3. Scottsdale City Court - Delinquent Accounts Receivable Aging As of June 30, Fiscal Years 06/07 and 07/08

		FY 06/07			FY 07/08	
_	< 4 Years	> 4 Years	Total	< 4 Years	> 4 Years	Total
Delinquent portfolio	\$13.9M	\$10.2M	\$24.1M	\$17.3M	\$10.7M	\$28.0M
% to total	58%	42%	100%	62%	38%	100%
No. of cases	21,276	15,248	36,524	27,949	14,555	42,504

SOURCE: Auditor analysis of revised Monthly Statistics Reports provided by Court management.

Allowance for Uncollectibles

As stated previously, the Court annually identifies a cumulative allowance for uncollectibles amount in lieu of writing off delinquent accounts. The Court estimates its allowance for uncollectibles using an aging report to identify the percentage of delinquent accounts that are unlikely to be collected. Table 4 shows the percentage of the Court's delinquent accounts receivable portfolio that is designated as uncollectible. In FY 06/07 64 percent or \$15.3 million of the total portfolio of \$24.1 million was designated as uncollectible as compared to 65 percent or \$18.3 million in FY 07/08.

Table 4. Scottsdale City Court - Allowance for Uncollectibles Percent of Delinquent Accounts Receivable Deemed Uncollectible As of June 30, Fiscal Years 06/07 and 07/08 (in millions of dollars)

	FY 06/07	FY 07/08
Delinquent Accounts Receivable	\$24.1	\$28.0
Allowance for Uncollectibles	\$15.3	\$18.3
% of portfolio deemed uncollectible	64%	65%

SOURCE: Auditor analysis of revised Monthly Statistics Reports provided by Court management.

According to the presiding judge, it would not be in the City's best interest to write off delinquent Court debts for the following reasons:

- 1. Justice would not be served if Court assessed fines and fees were dismissed for nonpayment.
- 2. There is no statute of limitation as to when a Court imposed fine or fee can be collected.
- 3. There is a lack of uniform judicial standards or guidelines such as amount, aging, and collection efforts required which would support writing off the fine or fee.
- 4. It would not be prudent to dismiss delinquent debts due to the Court's successful collection program. According to Court reports, the collection agency collected 27 percent of the referred delinquent accounts in FY 06/07 and 31 percent in FY 07/08.

Arizona Supreme Court FARE Program

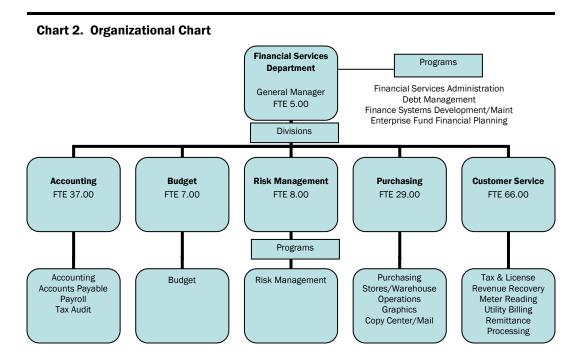
In addition to the Court's collection activities, the Arizona Supreme Court offers collection services to all courts within the state through their Fines, Fees, and Restitution Enforcement (FARE) Program. The program, which began in July 2003, provides a variety of collection resources for a predetermined fee paid to the Administrative Office of the Supreme Court. The FARE program is a public/private partnership. In addition to the courts, it includes the state Motor Vehicle Division (MVD), the state Department of Revenue, and a private vendor to perform routine collection services. All courts are strongly encouraged to participate in the program.

With the exception of the ability to place a hold on vehicle registrations, the City Court already has similar collection resources in place. As a result, the City Court submitted a waiver requesting that they not participate in the FARE program stating that the Court "uses a full array of collection and enforcement mechanisms for both new and aged cases." Additionally, City Court management noted that, "The use of AZTEC WIZARD $^{\text{TM}}$ quality assurance reports and automated processes assists the effectiveness of our work."

The waiver was approved by the Supreme Court and expired in March 2009. The Court recently submitted a request to extend the waiver through September 2009. The request states that the Court intends to transition all collection cases to the FARE program by December 2009. According to Court management, recent improvements in data exchange capabilities, coupled with access to MVD registration holds, make it beneficial to join the program.

Revenue Recovery

Revenue Recovery is one of five work groups located within the Customer Service division of the Financial Services Department as reflected in Chart 2. According to the City's Web site, the mission of Revenue Recovery is to provide assistance to any City department that indicates a need for collection assistance.



SOURCE: Auditor analysis of City of Scottsdale Budget Book, FY 07/08.

The Revenue Recovery budget for FY 07/08 included a staff of 13 FTEs², as follows: 5 Revenue Collectors, 3 Customer Services Representatives, 3 Systems Integrators, 1 Administrative Secretary, and 1 Manager.

Primary areas of collection include utility billings, transaction privilege (sales) taxes, licensing fee, and false alarm assessments. Additionally, Revenue Recovery staff provides collection assistance to WestWorld and Code Enforcement (a division of the Citizen and Neighborhood Resources Department).

Table 5 depicts the Revenue Recovery aged delinquent accounts receivable portfolio as of June 30 for fiscal years 06/07 and 07/08. The portfolio includes various accounts totaling \$2.8 million in FY 06/07 and \$3.0 million in FY 07/08. Transaction privilege (sales) taxes, at over \$2 million, make up the largest portion of the portfolio followed by utility billings at \$331,921 in FY 06/07 and \$423,667 in FY 07/08. These two types of accounts, which make up 94 percent of the total portfolio in FY 07/08, will be discussed in detail in the following sections of the report.

² The FY 08/09 budgeted FTE staff is 11 which consists of 5 Revenue Collectors, 3 Customer Service Representatives, 1 Systems Integrator, 1 Administrative Secretary, and 1 Manager.

Table 5. Revenue Recovery - Delinquent Accounts Receivable Aging As of June 30, Fiscal Years 06/07 and 07/08

_		FY 06/07		FY 07/08		
	31-120	> 120	Total	31-120	> 120	Total
Alarm	\$17,265	\$85,736	\$103,001	\$25,631	\$54,243	\$79,874
Business license	693	47,997	48,690	125	53,271	53,396
Liquor license	6,925	23,159	30,084	2,115	24,938	27,053
Taxes (Privilege)	812,039	1,203,230	2,015,269	616,689	1,753,440	2,370,129
Utility billing	331,921	-	331,921	423,667	-	423,667
Code						
Enforcement	35,950	274,561	310,511	2,550	-	2,550
WestWorld	4,627	-	4,627	-	30,033	30,033
Total	\$1,209,420	\$1,634,683	\$2,844,103	\$1,070,777	\$1,915,925	\$2,986,702
% to Total	43%	57%	100%	36%	64%	100%
No. of						
accounts	31-120	> 120	Total	31-120	> 120	Total
Alarm	771	2,450	3,221	837	665	1,502
Business license	14	492	506	5	436	441
Liquor license	10	33	43	3	38	41
Taxes (Privilege)	4,862	9,147	14,009	2,320	5,635	7,955
Utility billing (a)	1,384	-	1,384	1,365	-	1,365
Code						
Enforcement	143	268	411	4	-	4
WestWorld	2	-	2	-	1	1
Total	7,186	12,390	19,576	4,534	6,775	11,309

(a) The number of utility billing accounts is estimated based on the FY 06/07 and FY 07/08 Aging Report provided by Revenue Recovery management. Because the report only included the total number of accounts, the number of delinquent accounts (aged over 30 days) was estimated using information provided by the Financial Services Technology Director.

Requests, from other City departments, for Revenue Recovery's assistance has decreased significantly in FY 07/08. Code Enforcement accounted for \$310,511 of delinquent accounts receivable in FY 06/07. This has since been reduced to \$2,550 in FY 07/08 due to the discontinuance of administrative hearings in January 2009 as discussed in the Code Enforcement Follow-Up audit report dated January 14, 2009. Currently one WestWorld account for \$30,033 is being worked by Revenue Recovery staff. According to account notes, a certified letter was mailed to the customer. If no response is received, the account will be referred to the City Attorney's Office for assistance.

Transaction Privilege (Sales) Tax

Transaction privilege (sales) taxes are the largest grouping of accounts within the Revenue Recovery delinquent accounts receivable portfolio. As of June 30, 2008, taxes accounted for \$2.4 million or 79 percent of the \$3.0 million total delinquent portfolio.

A transaction privilege (sales) tax is imposed on a seller for conducting business activities within the City. Transaction privilege (sales) tax licensing, billing, and some collection activities, are performed using the GenTax system which was implemented in October 2005. The City's transaction privilege (sales) tax collection is governed by Appendix C of the City Code which is generally based on the Model City Tax Code. The Model City Tax Code is a uniform privilege tax code tailored to fit each city's individual needs.

Transaction privilege (sales) tax receivables are self-reported. If the entity reports, but does not remit the payment due, it is recorded as an accounts receivable. Other ways in which a tax receivable is created is by the automatic renewal of annual tax licenses, or through the efforts of Tax Audit staff, which identify delinquent taxes that were not previously filed or reported.

According to City Code Sec. 530, taxpayers who are scheduled to remit monthly are considered delinquent on the first business day following the month due. Interest and penalties are assessed one business day after the delinquent date. Per City Code Sec. 590, the recovery of delinquent privilege (sales) taxes is limited to within six years of the assessment of the tax.

The following interest and penalties are assessed on delinquent accounts per City Code Sec. 540 using the GenTax system:

Nonpayment of taxes:

- Interest calculated using the federal short-term rate, Section 6621 (b) of the Internal Revenue Code, plus 3 percent.
- Penalty 10 percent of unpaid taxes, not to exceed 25 percent of the tax due.

Untimely filing or failure to file tax return:

- Untimely filing 5 percent of the tax for each month, or fraction of month delinquent, not to exceed 25 percent of the tax due.
- Fails or refuses to file within 30 days of receiving notice—25 percent of the tax due.

Delinquent tax accounts are referred to Revenue Recovery staff when they are 60 days past due. Staff utilizes the following collection tools as appropriate:

1. Establishment of payment plans. Staff is authorized to issue payment plans for up to 18 months; payment arrangements outside this range

must be approved by the Revenue Recovery Manager. If the agreement is breached, the entire balance is due immediately.

Should a dishonored check be received, staff utilizes the County Attorney Check Enforcement Program which could result in possible criminal prosecution by their office.

- 2. Filing of complaints with the appropriate regulatory agency. If the account is six months or more delinquent, a complaint may be filed with the Arizona Registrar of Contractors or Arizona Department of Liquor License and Control, which could prevent the contractor from becoming licensed, or deter their ability to renew their license. Revenue Recovery staff filed 144 complaints in FY 07/08.
- 3. Issuance of either a property or blanket lien. If the amount owed is over \$100, and payment is not made within 30 days of a mailed pre-lien notice, a lien will be filed with the Secretary of State or the Maricopa County Recorder's Office. The \$15 cost of filing and releasing the tax lien is assessed to the account. Revenue Recovery staff filed 92 tax related liens in FY 06/07 and 112 in FY 07/08.
- 4. Revocation/cancellation of business license. Notices of cancellation are utilized as a last resort since this would prevent a business from operating, thereby reducing the City's ability to collect the delinquent account. Prior to cancellation of a business license, staff may conduct in person site visits, if other collection tools are unsuccessful.
- 5. Referral of the account to the Revenue Enhancement Team. The Revenue Enhancement Team consists of designated staff from Revenue Recovery, Tax and License (a program within Customer Service), and the City Attorney's Office. If the team determines that legal actions are prudent, an attorney demand letter may be issued. The demand letter states that the City will initiate legal proceedings if appropriate arrangements are not made to satisfy the debt within ten days of the date of the letter. In FY 07/08, the team collected \$141,991 from 12 accounts resulting in an 80 percent collection rate.

Utility Billing

Utility billings are the second largest grouping of accounts within the Revenue Recovery delinquent accounts receivable portfolio. As of June 30, 2008, utility billings accounted for \$423,667 or 14 percent of the \$3.0 million total delinquent portfolio.

Utility billings and some collection activities are performed using the NorthStar system which has been in effect since October 2005. A typical utility bill includes water, sewer, and solid waste. All utility bills, when issued, are recorded as an accounts receivable and are considered delinquent 20 days after the bill date. Per City Code Sec. 49-53.1, a \$5 late fee is assessed on the second occurrence of any unpaid balance not received by the next regular billing. In addition to the \$5 late fee, a 10 percent annual interest penalty, per ARS §9-511.02(d), is assessed to the unpaid sewer

portion of the utility bill. Per City Code Sec. 49-51, the recovery of delinquent utility fees is limited to the three-year period immediately preceding the date of the most recent billing.

In addition to the assessment of late penalties, which are automatically applied by the NorthStar system, the City can terminate water or sewer services and file a lien for nonpayment of accounts as follows:

- Water When the City turns off or attempts to turn off water service due to nonpayment of a delinquent amount, the user is assessed a \$25 fee per City Code Sec. 49-54(b). The City disconnected water service to 6,826 accounts in FY 06/07 and 6,662 accounts in FY 07/08 for nonpayment.
- Sewer Per City Code Sec. 49-148(c), sewer services can be terminated for nonpayment of a delinquent amount; the user is assessed a fee of \$500. According to the Customer Service Director, this option has not been exercised. The cost of performing this function, estimated at \$10,000, would far exceed the \$500 fee. Furthermore, sewer disconnection would make the residence uninhabitable.
- Property lien Per ARS §9-511.02, cities can impose a lien for delinquent sewer fees only. This statute requires that the City provide 30 days written notice to the delinquent customer prior to filing a lien. The pre-lien notice is to be personally served or sent by certified mail. Revenue Recovery staff filed 69 sewer related liens in FY 06/07 and 76 in FY 07/08.

The following progressive steps are taken by Revenue Recovery staff to collect delinquent utility accounts:

- 1. Issuance of a water disconnect notice. After two consecutive billings and within 11 days after the second bill date, a disconnect notice is sent. Delinquent accounts related to medical or personal hardships are occasionally referred to a charitable organization for assistance. In this situation, staff will arrange a payment plan to be paid by the organization. Payment plans can be made for up to six months.
- 2. Utilization of an auto dialer. An auto dialer, implemented in March 2008, is used to make between 200 and 300 calls per day. Management estimates that this has reduced the number of water disconnects by 33 percent.
- 3. Issuance of a pre-lien notice. If the sewer portion of the utility bill exceeds \$100, and the delinquent customer owns the property, a pre-lien notice is sent to the customer. If payment is not received within 30 days of the notice, a property lien is filed. The \$15 cost of filing and releasing the utility lien is assessed to the account.
- 4. Removal of the solid waste container. If the delinquent customer does not own the property, the account is routed to the Solid Waste Director,

or designee, requesting that the solid waste container be removed from the property until the account is paid in full.

Write Offs

According to Revenue Recovery policy, not all accounts go through the same collection process due to the costs associated with the delinquency and resources necessary to resolve the debt. If internal collection efforts are unsuccessful, and the account is over 180 days delinquent, it will be forwarded to the Revenue Recovery Manager to determine if the account should be written off.

Although the account may be written off, this does not immediately eliminate the debt owed to the City. Enforcement measures such as liens and complaints remain in place. Once identified for write off, utility accounts over \$50 are referred to a collection agency. Written off tax accounts are not referred to the collection agency due to concerns regarding the confidentiality of tax information.

As reflected in Table 6, \$591,716 of delinquent taxes was written off in FY 06/07 compared to \$493,199 the following fiscal year. Write offs of utility billings remained relatively flat at \$275,268 in FY 06/07 and \$283,304 in FY 07/08.

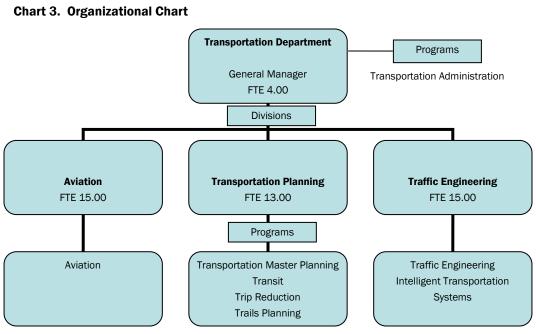
Table 6. Delinquent Accounts Receivable Written Off Taxes and Utility Billing Fiscal Years 06/07 and 07/08

	FY 06/07	FY 07/08
Taxes	\$591,716	\$493,199
No. of accounts	345	414
Utility billings	\$275,268	\$283,304
No. of accounts	620	485

SOURCE: Auditor analysis of approved annual write off memos dated June 25, 2007, and July 1, 2008.

Scottsdale Airport

The Airport/Aviation program is a division within the Transportation department and is responsible for the air transportation facility operation, maintenance, and administration of the City's Aviation Noise Abatement Program and is reflected in Chart 3. The Airport's FY 07/08 budget includes 15 FTEs, of which approximately .2 FTE is utilized for airport collection related activities.



SOURCE: Auditor analysis of City of Scottsdale Budget Book, FY 07/08.

The Airport's collection activity is performed by a Management Analyst. Since January 2008, the Management Analyst reported to the Airport Assistant Director. Prior to that, the position reported to the Airport Director. Airport receivables consist of the following accounts: airport access, US custom fees, transient landing fees, lease of city-owned property, and aircraft tie down fees. Collection methods include mailing notices to the delinquent customers, telephone contact, and placement on a Greet List (i.e., in person notification of possible denial of future service).

The Management Analyst works closely with Financial Services staff to collect delinquent funds through the utilization of the SmartStream financial system. The Accounting Division provides ongoing assistance to the Airport by performing monthly billings and issuing monthly accounts receivable aging reports. Accounting management estimates that they provide approximately .2 FTE to support the Airport's collection program.

Per City Code Sec. 5-117, penalties and other provisions for the determination, administration, and collection of privilege taxes also apply to airport related fees. As such, Airport billings are considered delinquent on the first business day following the month due. Interest and penalty fees are identical to those listed under the Revenue Recovery Transaction Privilege (Sales) Tax section on page 12.

Table 7 reflects the Airport's aged delinquent accounts receivable portfolio as of June 30 for fiscal years 06/07 and 07/08. Only 5 percent, or \$4,184, of the Airport's total delinquent portfolio of \$92,347 was older than 90 days in FY 06/07 compared to 4 percent, or \$2,840 in FY 07/08.

Table 7. Scottsdale Airport - Delinquent Accounts Receivable Aging As of June 30, Fiscal Years 06/07 and 07/08

	I	FY 06/07			FY 07/08	
-	30-90	> 90		30-90	> 90	
_	days	days	Total	days	days	Total
Lease/Tie downs	\$31,800	\$459	\$32,259	\$26,445	\$0	\$26,445
Airport Access	500	54	554	882	(322)	560
Customs	11,600	600	12,200	9,996	0	9,996
Transient Landing	44,263	3,071	47,334	23,014	3,162	26,176
Total	\$88,163	\$4,184	\$92,347	\$60,337	\$2,840	\$63,177
% to total	95%	5%	100%	96%	4%	100%
	30-90	> 90		30-90	> 90	
No. of accounts	days	days	Total	days	days	Total
Lease/Tie downs	12	1	13	15	0	15
Airport Access	8	2	10	10	1	11
Customs	13	1	14	20	0	20
Transient Landing	196	43	239	264	99	363
Total	229	47	276	309	100	409

SOURCE: Auditor analysis of Accounts Receivable aging reports per the City's Intranet.

Because leases and tie down fees are rarely delinquent after 90 days, Airport staff focuses collection efforts on transient landing fees.

Transient Landing Fees

A transient landing fee of \$1.50 per 1,000 pounds maximum certified take off weight is billed to transient aircraft customers utilizing the City's Airport. Airport staff collects transient landing fee information through the use of the Airport's electronic system which is manned 24 hours a day, 7 days a week. The system includes several monitors of runway activity, flight tracking software, and access to the Transportation Aircraft Database. All landing activity is recorded and verified using three independent sources of information:

- 1. An Airport system generated report depicting flight log information (incoming flights, flight path, etc.).
- A Landing Log which is manually updated and maintained by Airport staff based on actual landing activity as observed on the Airport system monitors.
- 3. A pilot completed transient landing "blue form" which is presented to the pilot by the Fixed Based Operators³ who concurrently provide their services to Airport customers.

The "blue form" includes the Federal Aviation Administration (FAA) recognized aircraft number which can be verified to accessible FAA data such as aircraft owner name and address. The form is forwarded to Airport operations staff

³ A Fixed Based Operator is defined as a commercial aviation operator performing services such as the sale of aviation fuel, aircraft tie down or other storage, and aircraft maintenance and repair.

at least once a day. On a daily basis the supervisor reconciles the "blue forms" to the system generated reports and Landing Log maintained by staff. On a monthly basis, data is downloaded from the Airport database and uploaded into the SmartStream financial system. Financial Services staff then processes, updates, and creates monthly invoices which are mailed to Airport customers.

Airport policy contains the following progressive steps used by staff to collect delinquent accounts:

- 1. Direct contact with the customer to seek payment. If phone contact cannot be established, a letter is mailed out immediately.
- Placement on a Greet List. If payment is not made, the account information is placed on a Greet List report to discuss the delinquency in person. If the flight crew/company refuses to make reasonable arrangements for payment of fees, the crew is informed that the company will not be able to utilize the Airport for future arrivals until fees are paid in full.
- 3. Referral to the City Attorney's Office or Revenue Recovery. If all collection and enforcement efforts have been exhausted, the case is worked by the City Attorney's Office or Revenue Recovery staff. Delinquent lease accounts are forwarded to the City Attorney's Office, while delinquent transient landing fees are forwarded to Revenue Recovery. According to Airport management these situations have been minimal, if any, in recent years.

Write Offs

Based on accounting reports provided to the Airport Management Analyst, delinquent aged accounts are identified. These accounts are then forwarded to Revenue Recovery management for inclusion in the annual write off memo submitted to the Financial Services General Manager.

As reflected in Table 8, Airport related account write offs are minimal. In FY 06/07 \$5,357 was written off compared to \$2,185 written off in FY 07/08.

Table 8. Delinquent Accounts Receivable Written Off
Airport Related Fees
As of June 30, Fiscal Years 06/07 and 07/08

	FY 06/07	FY 07/08
Airport fees	\$ 5,357	\$ 2,185
No. of accounts	60	32

SOURCE: Auditor analysis of write off reports provided by Revenue Recovery management.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of this audit were to:

- 1. Verify compliance with stated policies, procedures, and applicable laws.
- 2. Ensure that steps are taken to properly record the City's Accounts Receivable balance and the write off of delinquent funds.
- 3. Assess control activities and performance measures to ensure collection program objectives are met.
- 4. Assess and compare the effectiveness of selected collection programs.

The audit focused on three City collection programs: (1) criminal and civil fines and fees imposed and managed by the City Court, (2) utility billings and transaction privilege (sales) taxes managed by Revenue Recovery (a division of Financial Services), and (3) aviation related fees imposed and managed by the Scottsdale Airport (a division of Transportation). We reviewed collection activities applicable to fiscal years 06/07 and 07/08.

The audit of transaction privilege (sales) taxes was limited per City Code Sec. 510 regarding the confidentiality of taxpayer information. Audit staff signed a confidentiality form and were provided with requested account data after confidential information was redacted. Viewing of the GenTax system was limited to the displaying of specific information while in the presence of the Customer Service Director or Revenue Recovery Manager to avoid identification of taxpayer information.

To address the overall audit objectives we reviewed:

- 1. Policies and procedures, including records retention schedules, and department/division information as reflected on the City's Web site.
- 2. Legal and authoritative documents which included: Arizona Revised Statutes, the federal Fair Debt Collection Practices Act, Court Orders, Arizona Supreme Court Administrative Orders, and collection agency contracts applicable to the City Court and Revenue Recovery.
- 3. City of Scottsdale adopted Financial Policies, Scottsdale Revised City Code, City Charter, and Administrative Regulations.
- 4. The City of Scottsdale Comprehensive Annual Financial Reports and Budget Books for fiscal years 06/07 and 07/08.
- 5. Publications by the United States General Accounting Office (GAO) and the Government Finance Officers Association (GFOA).

Steps taken to conduct audit work included:

 Meetings and interviews with various employees in the Court, Financial Services, Transportation, and City Attorney's Office to enhance our understanding of the City's collection activities.

- 2. Meetings with systems support staff from Information Systems, Financial Services, and the City Court to gain an understanding of automated system controls applicable to designated systems: AZTEC WIZARD,™ GenTax, NorthStar, and SmartStream. We relied on System Administrator's statements of assurance that management identified collection criteria (City Code, state statute, procedures, etc.) is programmed within the designated systems.
- 3. Review of prior audit reports and publications applicable to collection activities.
- 4. Review of management provided reports, which included, but were not limited to: accounts receivable aging reports, annual write offs, and various collection activity reports.
- 5. Observation of the systems used by the auditees to process, monitor, and report collection activities.
- 6. Development of a Risk/Control Assessment Matrix which involved:
 - Identifying risks and the accompanying internal controls.
 - Analyzing the materiality of risks by their significance and likelihood.
 - Rating controls for adequacy and effectiveness.
 - Identifying controls to be included in the testing of collection activities.

Scottsdale City Court

- 1. To test compliance with stated policies and procedures performed by the AZTEC WIZARD™ system, we tested 40 randomly selected cases from the Court's 43,830 active cases as of November 24, 2008. Testing included: assessment of payment plan fee, notification letter, issuance of default/license suspension, issuance of warrant, referral to collection agency, and submission to the Arizona Department of Revenue Debt Setoff Program.
- To test compliance with Court Orders, we queried the Court's 43,830
 active cases as of November 24, 2008, to determine compliance with
 Court Orders regarding the suspension of aged and inactive low dollar
 cases.
- 3. To test the reasonableness of fiscal year reporting of accounts receivable and allowance for uncollectibles, we compared Court generated reports as of June 30, 2007, and 2008 to the corresponding annual financial reports. Additionally, we analyzed the number of reported delinquent accounts.
- 4. To compare the Court's collection program with other areas audited, we analyzed the Court's accounts receivable portfolio and reported delinquent dollars collected as of June 30, 2007, and 2008 with comparable data provided by Revenue Recovery and Airport staff.

Revenue Recovery

- 1. To test compliance with City Code as it relates to utility billings and transaction privilege (sales) taxes, we tested 80 randomly selected billings: 40 utility billings generated by the NorthStar system and 40 transaction privilege (sales) tax billings generated by the GenTax system. Delinquent utility billing accounts were selected from a total population of 57,318 as of December 18, 2008. Delinquent tax accounts were selected from a total population of 2,621 as of December 18, 2008. Testing of delinquent accounts included:
 - Assessment of interest accrued and tax penalties per City Code.
 - Assessment of late fees applicable to utility accounts per City Code and Arizona Revised Statutes.
 - Evidence of collection actions (phone contact, issuance of liens, complaints, and write offs) per Revenue Recovery procedures.
- To test compliance with stated timelines applicable to the issuance and removal of liens, we tested 30 liens consisting of 23 property liens and 7 blanket liens. The liens were selected from various reports provided by management as of November 2008, which reflected a total population of 349 liens.
- To test compliance with stated timelines applicable to the issuance of complaints filed with the Arizona Registrar of Contractors, we tested 15 complaints selected from management provided reports as of November 2008, which reflected a total population of 144 complaints.
- 4. To test write offs, we reviewed the annual write off memo and supporting documentation for fiscal years 06/07 and 07/08.
- 5. To test the reasonableness of fiscal year reporting of accounts receivable, we compared Revenue Recovery system generated reports as of June 30, 2007, and 2008 to the corresponding annual financial reports. Additionally, we analyzed the number of reported delinquent accounts and obtained year-end account reconciling information from the Accounting Manager.
- To compare Revenue Recovery's collection program with other areas audited, we analyzed the accounts receivable portfolio as of June 30, 2007, and 2008 with comparable data provided by Court and Airport staff.

Scottsdale Airport

1. To test compliance with City Code as it relates to Airport billings we selected 30 billings generated by the SmartStream system from a total account population of 248 delinquent accounts as of November 30, 2008. Statements were not available on 11 of the 30 accounts; staff explained this was due to the accounts being paid in full, or the dollar value of the remaining balance being less than \$2. Testing of the remaining 19 accounts included: assessment of interest accrued and

- tax penalties and application of collection actions (phone contact and placement on a Greet List) per Airport procedures.
- 2. To test write offs, we reviewed the Airport Aging Report Transient Landing Fee Accounts At Least 120 Days Past Due, dated September 3, 2008, which reflected 109 accounts. We also reviewed the annual write off memo and supporting documentation for fiscal years 06/07 and 07/08.
- 3. To test the reasonableness of fiscal year reporting of accounts receivable and write off data, we compared Airport SmartStream system generated reports as of June 30, 2007, and 2008 to the corresponding annual financial reports. Additionally, we analyzed the number of reported delinquent accounts and obtained year-end reconciling account information from the Accounting Manager.
- To compare the Airport's collection program with other areas audited, we analyzed the accounts receivable portfolio as of June 30, 2007, and 2008 with comparable data provided by Court and Revenue Recovery staff.

Audit work was conducted in accordance with generally accepted government auditing standards as they relate to expanded scope auditing in a local government environment and as required by Article III, Scottsdale Revised Code, Section 2-117, et seq. Generally accepted government auditing standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives. Audit work took place from October 2008 through March 2009. Lisa Gurtler was the Auditor in Charge. A portion of the audit testing was performed by Kyla Anderson and Joyce Gilbride.

EVALUATION OF MANAGEMENT CONTROLS

A control structure is in place, but could be strengthened to provide greater assurance of compliance or timely detection of noncompliance.

According to the Committee of Sponsoring Organizations (COSO), which is sponsored by five professional accounting associations and institutes, a sufficient control structure should exist to provide reasonable assurance that risks are mitigated and assets are safeguarded. To be considered sufficient, the following elements should be present:

- Control Environment Management is aware of the need for a control system and communicates this need with an attitude and awareness that sets the tone for the organization.
- Risk Assessment Relevant risks that impact compliance are identified, evaluated, and used as the basis for determining how to manage risk.
- Control Activities Policies and procedures are developed and documented.
- Information and Communication Usable, relevant information is captured and exchanged in a form and time frame that allows employees to effectively carry out their duties.
- Monitoring Periodic assessments of the control structure are undertaken to identify what is working and what needs to be improved or modified.

The following management controls provide some assurance that collection activities are accurately reported, sufficiently monitored, and practices are consistent with management approved procedures. These controls, particularly the use of automated systems, contribute to assurances that the City complies with applicable laws and regulations.

Scottsdale City Court

- 1. Useful and relevant reports. Both system and manually generated reports are available to assist with the monitoring of collection activities. However, we noted errors in the June FY 06/07 and FY 07/08 collection related reports (see page 27).
- Written and accessible policies and procedures. Cash custodian receipting processes are detailed and include numerous controls including random audits to ensure the safeguarding of cash and accuracy of case processing. We did, however, note conflicting information within the collection related policies (see page 28).
- 3. Adequately trained staff. Based on internal questionnaires provided to staff, they possess sufficient knowledge of the Court's case processing system, AZTEC WIZARD™. Management states that in addition to written procedure updates, all changes and updates are verbally communicated in staff meetings.

- Monthly update meetings. In person or telephone meetings are held between Court Management and representatives from the Court's collection agency.
- 5. Appropriate contract administration. Oversight and administration of the collection agency contract comply with Administrative Regulation 215 Contract Administration.
- 6. Timely execution of system generated activities. On a daily basis, the system checks the Court's database for specific conditions resulting in automated collection activities which include: issuance of a past due notice, scheduling of a future court date, and submission of cases to the Court's collection agency. We did, however, note that the system did not identify some low dollar inactive accounts eligible for suspension per judicial order (see page 27).
- 7. Sufficient AZTEC WIZARD™ system controls. We relied on the Lead Systems Integrator's statement as to the existence of sufficient system controls. According to the Court's Lead Systems Integrator, access to program code is limited to two staff members. When a change is made the programmer is required to document and initial the change within the code. Previous versions of executable program code are maintained and available to compare with the current version to detect any changes.

Accuracy is verified through:

- Issuance of daily quality controls reports reviewed by Court Service Representatives.
- Compliance with Minimum Accounting Standards as required by the Arizona Supreme Court Administrative Office of the Courts.
- Monthly reconciliation of collection agency invoices to case data.

Revenue Recovery

- 1. Useful and relevant reports. Both system and manually generated reports are available to assist with the monitoring of collection activities and to identify trends.
- Written and accessible policies and procedures. Procedures are available to staff and were recently updated. However, we did note conflicting information within the policies. Additionally, we found that stated collection activities were not consistently followed (see page 32).
- 3. Highly experienced staff. Staff questionnaires and interviews with management reflect the presence of experienced senior staff within the work group.
- 4. A Memo of Understanding depicting the responsibilities of Revenue Recovery and Code Enforcement staff. Assigned responsibilities are specific and include timelines for progressive actions taken on delinquent Code Enforcement accounts.

- 5. Appropriate segregation of duties. Revenue Recovery staff is prohibited from accepting direct payment from customers. The only exception is the ability of staff to accept credit card payments for water and annual license fees as part of their phone contact with delinquent customers.
- 6. Appropriate and ongoing training. Results of questionnaires indicate ongoing training from senior members of the work group. Additionally, staff acknowledges the availability of management to answer questions and their ability to elevate problematic accounts when a customer request exceeds their authorization.
- 7. Monthly meetings. Management meets with staff in the City Attorney's Office, and other work groups within Customer Service including Utility Billing and Tax and License to discuss City Code revisions and work process impacts. Additionally, management meets every other month with other local cities regarding utility billing collection practices and twice a year regarding the collection of taxes.
- 8. High sensitivity to protecting confidential tax information. Staff is required to comply with confidentiality requirements per City Code Sec. 510. Additionally, staff is required to sign a confidentiality agreement annually.
- 9. Management developed performance measures. Management reports the average number of delinquent accounts, dollars collected for every \$1 spent, and write-offs as a percentage of revenue. However, we were unable to verify the dollars collected directly attributable to Revenue Recovery efforts. Additionally, the write off as a percentage to revenue was not calculated in accordance with Council-adopted Financial Policy 16 (see page 31).
- 10. Sufficient GenTax and NorthStar system controls. We relied on the Technology Director's statement as to the existence of sufficient system According to the Financial Services Technology Director, controls. specifications are provided to the integration staff from Customer Service management. These specifications are compared to applicable code sections, when appropriate, and then used to drive configuration as needed. The Technology Director further explained the system can only be changed by authorized personnel whose network user accounts are granted access. The security relies on the core security infrastructure model of the City of Scottsdale's Windows Domain Controllers. All system configuration updates are tested to ensure that processed transactions are valid and payment is accurately applied. However, we found that interest was not applied to delinquent sewer accounts as required by ARS §9-511.02 and §44-1201 (see page 33). Additionally, we noted that a \$5 late fee was not applied to delinquent utility accounts less than \$15 as required by City Code Sec. 49-53.1 (see page 34).

Scottsdale Airport

- 1. Written and accessible policies and procedures. Procedures are available to staff, however, we did note that some of the procedures were not comprehensive (see page 37).
- 2. Useful and relevant Airport accounts receivable reports. SmartStream system developed reports are provided monthly. Applicable financial updates are provided to the Airport Advisory Commission on a monthly basis
- 3. Limited processing of cash transactions. Management states that approximately 90 percent of all Airport related fees are receipted by Financial Services staff; the remaining 10 percent is processed by designated Airport cashiers.
- 4. Reconciliation of reports. On a daily basis, Airport database generated reports are reconciled to the manual Landing Log and pilot completed information. This reconciliation ensures that assessment of the transient landing fee is accurate and complete prior to forwarding the information to Financial Services for actual billing.
- 5. Timely exchange of accounts receivable data. Information from the Airport's database is downloaded electronically on the 25th of each month to Financial Services staff for bill processing.
- 6. Sufficient SmartStream system control. We relied on the Technology Director's statement as to the existence of sufficient system controls. According to the Financial Services Technology Director, specifications were provided to the integration staff from Accounting and Budget management. These specifications are compared to applicable code sections, when appropriate, and then used to drive configuration as needed. The Technology Director further explained that the system can only be changed by authorized personnel whose network user accounts are granted access. The security relies on the core security infrastructure model of the City of Scottsdale's Windows Domain Controllers. All system configuration updates are tested to ensure that processed transactions are valid and payment is accurately applied. However, we found that interest was not charged to delinquent Airport accounts through the date of final payment as required in City Code Sec. 540 (see page 38).

FINDINGS AND ANALYSIS

To develop the findings outlined in this section, we:

- 1. Verified compliance with stated policies, procedures, and applicable laws (see findings 3, 6, 7, 9, 10, 12, 14, and 15).
- 2. Ensured that steps are taken to properly record the City's Accounts Receivable balance and the write off of past due or delinquent funds (see findings 1, 2, and 8).
- 3. Assessed control activities and performance measures to ensure collection program objectives are met (see findings 4, 5, 11, 13, and 16).
- 4. Assessed and compared the effectiveness of selected collection programs (see Appendix A).

SCOTTSDALE CITY COURT

1. The reported accounts receivable balance was erroneously understated by \$1.4 million in FY 06/07.

The United States General Accounting Office publication, *Internal Control Management and Evaluation Tool*, states documentation of transactions and other significant events should be complete and accurate. It was determined the Court's Accounts Receivable and City's annual financial report, for FY 06/07, were understated by \$1.4 million; correspondingly, the Allowance for Uncollectibles was understated by \$.4 million. Court management explained that an error occurred when the Court restated the agency fee applicable to their accounts receivable portfolio.

Additionally, several errors were identified on the Monthly Statistics Reports issued for June 2007 and June 2008 as they relate to the reporting of collection activities. Examples include: (1) Accounts Receivable Aging report totals did not agree to the total accounts receivable portfolio, (2) reported fiscal year-to-date amounts were greater than multi-year program incept-to-date amounts, (3) the prior fiscal year report ending balance was not brought forward accurately to the next fiscal year, and (4) reported net amounts were higher than gross amounts. The Court's staff-prepared reports were not properly monitored to ensure the accuracy of information.

Recommendation: Develop written procedures for the reporting of collection statistics; include control total checks within the Excel worksheet to alert the preparer of detected errors. Require management review and approval of reports prior to distribution.

2. The Court's automated system did not identify some cases eligible for suspension per judicial order.

Court Order 2004-05 stipulates that the delinquent balance be suspended for all civil and criminal cases meeting the following criteria:

- The unpaid balance is all that remains and is less than or equal to \$25.
- The unpaid balance is over 30 days delinquent from when ordered by the Court or per the terms of the payment plan.

We found 20 eligible cases out of 43,830 that met the criteria for suspension as of November 24, 2008. The Court automated system failed to identify these cases. As a result, the judicial order was not followed. However, there was minimal impact to the Court's Accounts Receivable balance calculated to be \$379.

Recommendation: Update AZTEC WIZARD™ program code to properly identify cases which meet the requirements for suspension per Court Order 2004-05.

3. Management did not update documented procedures to be consistent with stated practices.

Both the Government Finance Officers Association recommended practices and the United States General Accounting Office publication, *Internal Control Management and Evaluation Tool*, cite the need for written policies. The following inconsistencies were found in Court policies:

- Court policy includes references to two collection tools: phone contact and garnishment of wages. It was determined that neither of these tools had been utilized by the Court for several years.
- Court policy states that a pre-collection letter is issued within 19-20 days after the missed payment. However, the Court's case management system (AZTEC WIZARD™) issues the pre-collection letter on day 15 for civil cases. Delinquent criminal cases are referred directly to the collection agency on day 18 if no payment is received or the defendant failed to appear in Court.
- Court policy states that cases assigned to the collection agency are delinquent for at least 33 days. However, the Court's case management system automatically refers delinquent civil cases by day 26 to the collection agency; criminal cases are referred by day 18.
- Court policy includes reference to Court Order 01-01 dated January 26, 2001, which orders the suspension of post adjudicated cases that are over five years in age and do not involve restitution. It was determined that the Court Order was a one-time order, applicable to a special project that expired in 2001.
- Court policy states that debts over \$250 will be subject to wage garnishment and that cases aged over six months will be referred to a secondary collection agency. It was determined that neither of these practices had been in place during fiscal years 06/07 and 07/08.

Lack of management oversight of existing policies and procedures could result in the misunderstanding of processes by Court staff and inconsistent or inaccurate information provided to Court defendants.

Recommendation: Ensure Court system program code corresponds with management developed policies regarding the timing of significant events and processes critical to the enforcement of Court ordered monetary penalties. Update Court policies to exclude practices that have been discontinued.

4. Management did not establish performance measures to assess contractor performance.

Performance measures are cited in the United States General Accounting Office publication, *Internal Control Management and Evaluation Tool*, as a necessary internal control. Additionally, the National Center for State Courts recognizes the need for performance standards to measure court performance and to make improvements to meet the needs and expectations of the public. Although the Court prepares Monthly Statistics Reports which includes collection agency activity, there are no cited expectations of collection agency performance. Without management identified program or contractor expectations there is limited ability to assess program performance.

Recommendation: Identify appropriate program performance measures and consider including them as part of the Court's Monthly Statistics Reports and as contractual terms within the Court's collection agency contract.

REVENUE RECOVERY

Additional delinquent taxes could be collected if previously written off accounts were referred to a collection agency as allowed by City Code.

According to City Code Sec. 510(e), the City may divulge delinquent and unpaid tax information to a private collection agency. Additionally, City Code Sec. 590, states that collection efforts related to delinquent taxes must be made within six years after the assessment of the tax. According to management, only six written off sales tax accounts have been sent to the collection agency since 2002. During the last seven years, management discontinued the practice of referring any written off sales tax accounts to the collection agency.

Based on estimates provided by the collection agencies currently utilized by the City Court and Revenue Recovery, the City's estimated lost revenue is between \$246,020 and \$615,050 as reflected in Table 9. One agency estimated they could collect 10 percent of the written off taxes; the second agency estimated they could collect 25 percent. These estimates were provided in November 2008 and may not reflect current economic conditions.

Table 9. Estimate of Written Off Privilege Taxes Collectible by an Outside Collection Agency

Fiscal Year	Tax Write Offs	Estimated @ 10% City Court's Collection Agency	Estimated @ 25% Revenue Recovery's Collection Agency
07/08	\$493,199	\$49,320	\$123,300
06/07	591,716	59,172	147,929
05/06	1,060,181	106,018	265,045
04/05	315,105	31,511	78,776
03/04	not available	-	-
02/03	not available	-	-
Total	\$2,460,201	\$246,020	\$615,050

SOURCE: Approved privilege tax write offs for fiscal years 04/05 through 07/08. Estimates of collections provided by Linebarger, Goggan, Blair & Sampson and Valley Collections Service.

The Revenue Recovery retention schedule, which requires tax write off information be retained for four years, does not coincide with City Code, which states that the City has six years to recover delinquent taxes. Therefore, no estimate for recovery of delinquent taxes could be provided for fiscal years 02/03 and 03/04.

Recommendation: Utilize available cost effective collection methods. Revise the Revenue Recovery records retention policy to coincide with the City Code recovery of delinquent debt period.

6. The collection agency contract was not updated for 16 years.

Administrative Regulation 215, *Contract Administration*, states that contract administration is the management, supervision, and monitoring of the execution of the terms, conditions, and specifications of the contract. The Contract Administrator is the primary source for day-to-day administration and update of the contract provisions.

The collection agency contract utilized by Revenue Recovery staff had not been updated since 1993; the contracted collection fee was 33.3 percent. During the course of this audit, a new contract was entered into effective October 2008. The terms of the contract are for a period of one year with the option to extend the contract for four years; the contracted collection fee is 17 percent. Lack of contract administrator oversight limits the assurance that contracted services are relevant, necessary, and cost effective.

Recommendation: Comply with contract administrator requirements.

7. No recent formal evaluation of alternative service delivery for collection efforts was performed as required by Council-approved financial policy.

Financial Policy 14 states, "Alternative means of service delivery will be evaluated to ensure that quality services are provided to our citizens at the

most competitive and economical cost. Departments, in cooperation with the City Manager, will identify all activities that could be provided by another source and review options/alternatives to current service delivery. The review of service delivery alternatives and the need for the service will be performed annually or on an opportunity basis."

The review of service delivery alternatives, as related to Revenue Recovery practices, was not performed annually or on an opportunity basis. Examples include:

 No formal consideration or analysis as to the potential benefit of adopting an ordinance, similar to the City Court (Sec. 9-8.1), which allows the cost of the collection agency to be passed to the delinquent customer. A portion of City Code Sec. 9-8.1 is reprinted below.

Sec. 9-8.1. City court collection agency fees and charges.

- "...The collection fees and charges assessed by the collection agency shall be added to the sum or sums due from and chargeable against the defendant."
- No analysis to explore possible contractual arrangements with a collection agency to perform routine collection functions such as the issuance of past due and pre-lien notices at predetermined time intervals.
- No analysis as to whether it would be in the City's best interest to forward all written off accounts to a collection agency, for credit bureau reporting, which could actually extend the City's recovery period.

Per City Code, the recovery period for utility billings and taxes is limited to three and six years respectively. According to the City Attorney's Office, based on their review of the Fair Credit Reporting Act, it appears that there is no requirement to remove an unpaid account from a credit bureau report even though the statute of limitations has run. The length of time the unpaid utility and tax debt can remain on a credit bureau report is up to seven years.

According to management, staff has been focused on implementing and monitoring the GenTax and NorthStar systems which were put into operation October 2005. Limited ability to analyze alternative delivery of services reduces the assurance that services are provided at the most competitive and economical costs.

Recommendation: Analyze existing collection practices to determine if alternative cost-effective collection methods are available and in the best interest of the City.

8. The annual write off percentage was not calculated as stated in Council-approved financial policy, and in two instances management was unaware of either the requirement to write off delinquent accounts or that accounts had been written off.

Financial Policy 16 states, "The City will follow an aggressive, consistent, but sensitive to the circumstances policy of collecting revenues to the limit of our ability. Collection policy goal will be for all adjusted uncollectible accounts to be no more than one half of 1 percent of the total City revenue being adjusted for bad debts annually." The policy, as stated, does not accurately depict the intended measure.

Revenue Recovery management provides the Financial Services General Manager with an annual write off memo which includes the proposed write offs as a percent to specific revenues, rather than to total City revenues as stated in policy. Examples of excluded revenue, with corresponding collection activity, are the City Court which had FY 07/08 revenues of \$11.1 million4 and smaller areas such as WestWorld and the Library.

In addition to excluded revenues, we noted the following related to City libraries and the Scottsdale Airport:

- Library The approved annual write off memo did not include a write off applicable to City libraries. Based on our inquiry, library staff stated that they estimate their write off amount, as of June 2008, to be approximately \$228,000, which represents seven years of delinquent accounts. It was explained that this amount was not reported to Financial Services because they were not aware of a requirement to do so.
- Airport According to Airport management they were unaware of the Airport annual write off amount or what criteria was used to identify which accounts would be written off. It was determined that the Airport Management Analyst identified delinquent aged accounts which were forwarded to Revenue Recovery management for inclusion in the annual write off memo submitted to the Financial Services General Manager.

Lack of an updated policy to reflect management's intended measure for annual write offs limits the usefulness of the calculation. Had the Court's revenues been included in the calculation, the percent written off would have actually been more favorable. Additionally, not having written instructions requiring City departments to submit annual write offs to the Accounting Division, coupled with no requirement that department management approve the proposed write offs, increases the risk that the accounts receivable balance may be misstated.

Recommendation: Update Financial Policy 16 to specify which City revenues should be included in the calculation to achieve its stated purpose to establish "...guidelines against which current budgetary performance can

⁴ General Fund: \$8.4M; Court Enhancement Fund; \$1.4M; Judicial Collection Enhancement Fund: \$.2M; and Photo Enforcement: \$1.1M.

be measured and proposals for future programs can be evaluated." Develop written documentation requiring the reporting of annual accounts receivable information. Ensure the appropriate level of division management approves the write off of City debt applicable to their area of responsibility.

9. Documented procedures were conflicting, and stated collection activities were not consistently applied.

Both the Government Finance Officers Association recommended practices and the United States General Accounting Office publication, Internal Control Management and Evaluation Tool, cite the need for established written policies. Although written policies and procedures are available, we found multiple procedures with conflicting directions. In addition, testing revealed that staff did not consistently apply stated collection activities.

Examples include the following:

- Phone contact. The policy titled Transaction Privilege Sales Tax Collection Procedure directs staff to call the customer if the receivable is 90 plus days delinquent. However, the policy titled Revenue Recovery Write off Procedure states that delinquent account customers will be contacted by phone within 45 days of assignment.
 - Testing of 40 tax accounts reflected either no telephone contact, or a significant lapse in phone contact on 22 accounts.
- Delinquent amount criteria for issuance of a lien. The policy titled Disconnected Account Details Procedure and Transaction Privilege Sales Tax Collection Procedure states that liens are filed for accounts with a balance greater than \$100. However, the policy titled Revenue Recovery Write Off Procedure states that any balance above \$149.99 should be sent a pre-lien notice.
 - Testing of 40 utility accounts found that liens were erroneously placed on five accounts with delinquent sewer fees less than \$100. Testing of 40 tax accounts found that liens had not been filed for 11 accounts even though they met the criteria.
- Delinquent account age criteria for issuance of a complaint. The policy titled Filing Procedures with Arizona Registrar of Contractors states to file a complaint, the business should be "six months or more delinquent..." However, the policy titled Transaction Privilege Sales Tax Collection Procedure directs staff to file a complaint when the account is 120 plus days delinquent.

Testing of 40 accounts found two accounts, meeting the stated criteria, with no filed complaint. Additionally, we found one account with a filed complaint, but the account was only three months delinquent and therefore did not meet established criteria.

Delinquent amount criteria for referral to City Attorney's Office. The
policy titled Transaction Privilege Sales Tax Collection Procedure states,
"should the balance exceed \$2,999.99, route the file to be worked in
conjunction with the City Attorney's Office for a demand letter to be sent."
However, according to City Attorney Office staff, the demand letter
threshold is \$5.000.

Liens, prompt phone contact, complaints, and issuance of demand letters are important tools used in the collection of delinquent funds. Management cited cost benefit for the reason that collection activities were not consistently applied, but could not provide a minimum dollar threshold or maximum lapse of time for which activities should occur. Conflicting policies and procedures resulted in inconsistent collection enforcement activities applied to delinquent customers.

Recommendation: Update procedures to reflect the criteria and dollar thresholds used by management to determine minimum account value and maximum lapse of time acceptable prior to initiation of stated collection activities. Work with Systems Integrators to identify collection activities that can be performed and monitored by the system to ensure compliance and timely action of stated collection practices. Determine if it would be cost effective to outsource selected collection activities.

Issuance and filing of liens, and assessment of late penalties applicable to delinquent utility accounts, do not comply with Arizona Revised Statutes.

- ARS §9-511.02 states that before filing the lien for delinquent utility user fees, written notice should be given to the property owner at least 30 days prior to filing the lien. Additionally, the statute states that the lien can only be filed for delinquent sewer fees (not water or solid waste fees).
 - Audit testing revealed that utility liens filed prior to 2008 were filed after giving the property owner only 15 days notice. Moreover, the filed lien amounts erroneously included delinquent water and solid waste fees in addition to sewer fees. State statute was not followed prior to 2008 because management was unaware of the requirements.
- ARS §9-511.02 and §44-1201 state that unpaid sewer utility fees accrue
 interest at the rate of 10 percent unless a different rate is contracted for
 in writing. Testing of delinquent utility accounts found that the City does
 not charge interest on unpaid sewer fees. Management was unaware of
 this requirement. Based on limited testing, the estimated annual lost
 revenue is between \$2,000 and \$4,000.

Recommendation: Annually review applicable sections in state statute to ensure compliance. Update NorthStar program code to recognize, report, and apply a 10 percent penalty to the sewer portion of delinquent utility bills. Update the lien document title from "Notice and Claim of Water, Sewage, and Refuse Lien" to "Notice and Claim of Sewage Lien."

11. Lien documents incorrectly stated the amount of interest assessed to the delinquent account.

City Code Sec. 540 states that the rate of interest for tax underpayments is calculated at the federal short-term rate plus 3 percent. Although testing confirmed that interest was being applied correctly, some tax liens inaccurately stated that interest was assessed at 1 percent; others did not contain a statement on interest assessment. Management was not aware the lien documents were incorrect. Inaccurate statements regarding the assessment of interest could result in unnecessary confusion to the customer and invalidation of the lien.

Recommendation: Determine if the lien process can be automated to eliminate variation in lien documentation.

12. Late fees are not applied to all delinquent utility accounts as required by City Code.

According to City Code Sec. 49-53.1, all delinquent utility accounts will be charged a \$5 late fee. Testing revealed the \$5 late fee is only applied to delinquent accounts equal to or greater than \$15. Management did not seek Council approval for this exception because they were not aware that the current practice was in conflict with City Code.

Recommendation: Comply with City Code Sec. 49-53.1 or seek Council approval to continue the current practice.

13. Reported performance measures were unverifiable and conflicting regarding the dollars collected for every dollar spent.

Performance measures are cited in the United States General Accounting Office publication, *Internal Control Management and Evaluation Tool*, as a necessary internal control. Although performance measures have been established, we found conflicting information regarding the reporting of dollars collected as a result of actual expenditures incurred.

The following performance measure, reflected in the FY 07/08 Budget Book, states that in FY 06/07 Revenue Recovery collected \$28.45 for every \$1 spent. Using this information, the calculated dollars collected is \$26.6 million as reflected in Table 10.

Table 10. Revenue Recovery Performance Measure

Revenue Recovery actual expenditures (FY 06/07)
Reported dollars collected for \$1 spent
Calculated dollars collected

\$933,249 X \$28.45 \$26,550,934

SOURCE: Auditor analysis of the FY 07/08 Budget Book.

The calculated dollars collected of \$26.6 million conflicts with City web site information, which states that through Revenue Recovery's effort an average of \$1,500,000, is collected every month as shown in Table 11. Using this information the calculated dollars collected is \$18.0 million or \$8.6 million less than the reported performance measure.

Table 11. Revenue Recovery Web Site

Average monthly collection \$1,500,000 No. of months X 12 Calculated dollars collected \$18,000,000

SOURCE: Auditor analysis of the City's Web site.

Lack of verifiable and conflicting data to report actual collections of delinquent funds limits management's ability to assess program performance.

Recommendation: Continue to develop verifiable reports to depict collections of delinquent funds referred to Revenue Recovery.

SCOTTSDALE AIRPORT

14. Management did not sufficiently document procedures applicable to key collection activities.

Both the Government Finance Officers Association recommended practices and the United States General Accounting Office publication, *Internal Control Management and Evaluation Tool*, cite the need for established written policies. Although the written policies and procedures are available, they did not include the following:

- Refunding of a credit balance (overpayment). On the Airport Aging Report dated November 5, 2008, we noted 37 of the 600 accounts contained a credit balance.
- Criteria used to identify accounts to be written off. On the Airport Aging Report dated September 3, 2008, we noted 45 of the 109 accounts with a balance due of less than \$10, which had been outstanding for at least 120 days, meaning that the balance was at least from the prior fiscal year.
- Adjustment of assessed late penalties and the required level of management approval. On the Airport Master List, dated September 3, 2008, we noted that one of the 503 accounts contained the comment, "...credit ½ of finance charge over life of account, (\$461), ok to credit to keep customer satisfied..."
- Exceptions to stated practices. We identified the six largest delinquent
 accounts and asked staff to provide any available documentation to
 support collection activities. Staff stated no collection/enforcement had
 been applied to these accounts because the customer continued to
 make regular payments although no payment plan had been established.
- Retention of documentation to demonstrate collection efforts. Airport staff was unable to provide evidence of stated collection practices such as placement on the Greet List or notification letters applicable to selected aged delinquent accounts. Additionally, the Airport records retention schedule did not address retention requirements applicable to collection activities.

Lack of sufficiently detailed policies and procedures can result in the inconsistent treatment of delinquent customers.

Recommendation: Existing policies should be expanded to address the refunding of overpayments, write off of accounts, unauthorized removal of finance charges and late penalties, and collection activity records retention requirements. Update existing Airport policies to reflect management approved collection practices regarding placement on a Greet List and issuance of notification letters.

15. Interest was not assessed through the date of final payment as stated in City Code.

Per City Code Sec. 540, any taxpayer who fails to pay the assessed tax before the delinquency date will pay interest on that tax until paid. We reviewed 19 transient landing fee accounts and found that 12 were subject to interest. Although all were charged monthly interest, none were charged interest through the date of final payment. Because the SmartStream financial system does not apply interest through the date of final payment, delinquent customers are not assessed the correct amount of interest. Based on limited testing, the annual lost revenue to the City is minimal and estimated at less than \$500.

Recommendation: Modify the SmartStream Accounts Receivable module to apply interest in conformance with City Code Sec. 540. If the system is unable to be modified, obtain appropriate approval for the current practice.

16. Management did not establish performance measures to assess program performance.

Performance measures are cited in the United States General Accounting Office publication, *Internal Control Management and Evaluation Tool*, as a necessary internal control. Airport management has not established reportable performance measures applicable to its collection activities. As a result, there is limited ability to assess program performance.

Recommendation: Identify, implement, and report effective performance measures.

MANAGEMENT RESPONSE



Scottsdale City Court

B. Monte Morgan Presiding Judge

Janet G. Cornell Court Administrator 3700 N. 75th Street Scottsdale, AZ 85251

PHONE 480-312-2442 FAX 480-312-2764 FAX 480-312-2305

Date: May 8, 2009

Memo to: Brent Stockwell, Acting City Auditor

From: B. Monte Morgan, Presiding Judge

Subject: Management Response, Audit 0906, "Collection of Delinquent Funds"

Enclosed with this memorandum is the Management Response from the City Court on the City Auditor's Office Audit Report No. 0906 on the "Collection of Delinquent Funds."

By this response we are pleased to provide our Management Response, Proposed Solution, Responsible Party and Completion Date on each of the four findings identified in the audit, which was conducted during recent months. We offer our appreciation and thanks for members of the City Auditor's Office, and in particular for Lisa Gurtler, Assistant City Auditor, who conducted the audit. We make note of the professionalism and thoroughness, and it is appreciated.

In closing, we appreciate the opportunity to evaluate the operations of our collection efforts, and are dedicated to continual improvement.

Enclosure: Management Response to Audit 0906

Copy to: Janet G. Cornell, Court Administrator

MEMORANDUM

May 6, 2009

TO: Brent Stockwell, Acting City Auditor

FROM: Debora Johnson, Customer Service Director

SUBJECT: Response to Collection of Delinquent-Funds Audit No. 0906

We appreciate the work performed by Auditor Kyla Anderson and Assistant City Auditor Lisa Gurtler in completing the Collection of Delinquent Funds Audit No. 0906. The audit work both validated the ongoing efforts currently being undertaken to limit the city's risk through recovery of revenues and also provided important recommendations towards improvement of processes, controls, and the need for additional analysis of efforts.

Revenue Recovery's current efforts to maintain a low delinquency rate in relationship to total revenues available to collect is demonstrated below. We appreciate the opportunity to collaborate with Internal Audit and will utilize the information presented to continue strengthening our collection effort.

Fiscal Year 06/07

1 10001 1 COI CO/O1		
Total Revenues Available to Collect	\$:	334,595,800
Total Revenues Collected	\$ 3	324,014,200
Total Outstanding Revenues at June 30, 2007	\$	10,581,583
Total Delinquent Outstanding Revenues at June 30, 2007	\$	2,844,103
Percentage of Delinguency to Revenues Available to Collect		85%

Fiscal Year 07/08

Total Revenues Available to Collect	\$:	339,011,700
Total Revenues Collected	\$:	327,886,700
Total Outstanding Revenues at June 30, 2007	\$	11,124,949
Total Delinquent Outstanding Revenues at June 30, 2007	\$	2,986,702
Percentage of Delinquency to Revenues Available to Collect		.88%

Note: "Total Revenues Available to Collect" includes all accounts receivables assigned to the Customer Service Division to collect.

Please find our written response to the audit findings attached which includes our timeline for completion. As noted in the action plan, staff has initiated steps or completed changes to correct the majority of the findings based on preliminary conversations and memos from your office

I want to thank you and your staff for your efforts on this audit

C. John Little, City Manager
Neal Shearer, Assistant City Manager
Scott McCarty, Financial Services General Manager
Richard Chess, Accounting and Tax Audit Director
Ruben Hernandez, Customer Service Manager

Memorandum

To: Brent Stockwell, Acting City Auditor

From: Scott Gray, Aviation Director for Scott Gray

Thru: Mary O'Connor, Transportation General Manager

Date: May 8, 2009

RE: Collection of Delinquent Funds, Audit No. 0906

Thank you for your report identifying opportunities for efficiencies in Airport collection of fees due the City. We appreciated working with Lisa Gurtler. As an enterprise fund organization, Airport's effective collection of monies due is a key area for strong management control. The attachment sets out our response to the portion of the audit's recommendations regarding Airport operations.

In addition, while the report's recommendation no. 8 is not listed on the Airport Action Plan, we want to note that we have made changes to improve Airport billing and collection processes. Written procedures now clearly state that the Aviation Director is responsible to approve classification of accounts receivable as uncollectible.

SCOTTSDALE CITY COURT

1. The reported accounts receivable balance was erroneously understated by \$1.4 million in FY 06/07.

MANAGEMENT RESPONSE: Court management agrees with the finding.

PROPOSED SOLUTION: Court management has developed written procedures for the reporting of collection statistics and instituted control total checks and a formal report review and approval process prior to publication and distribution of any statistical report.

The accounts receivable total was corrected and reported to Financial Services Accounting Division. Court management has made changes to the year-end automated processes that will detect and prevent this type of occurrence.

RESPONSIBLE PARTY: The Deputy Court Administrator and Court's Sr. Management Analyst have been charged with the responsibility to ensure the monthly collection reports are accurate prior to their publication and distribution.

COMPLETED BY: May 1, 2009

2. The Court's automated system did not identify some cases eligible for suspension per judicial order.

MANAGEMENT RESPONSE: Court management agrees with the finding. The computer program's selection criteria that identifies delinquent account balances per Court Order 2004-05 has been reviewed and updated to include the types of cases and or situations that were noted during the audit. The 20 cases that were noted in the audit have been properly suspended.

PROPOSED SOLUTION: Court staff will review automated process criteria used to support a given court order prior to placing the process in production. This will ensure that automated processes include all of the criteria as noted in the court order.

RESPONSIBLE PARTY: Deputy Court Administrator and Court Lead System's Integrator

COMPLETED BY: Program changes were made in January, 2009

3. Management did not update documented procedures to be consistent with stated practices.

MANAGEMENT RESPONSE: Court management agrees with the finding.

PROPOSED SOLUTION: Court staff will update procedures on a timely basis. The policies and procedures noted have been updated to reflect current

practices. In addition, all court policies and procedures are being re-vamped and updated. We are committed to reviewing all policies at least annually to ensure they reflect current operational practices.

RESPONSIBLE PARTY: Deputy Court Administrator and Sr. Management Analyst

COMPLETED BY: Completed on May 7, 2009

4. Management did not establish performance measures to assess contractor performance.

MANAGEMENT RESPONSE: Court management agrees with the finding.

PROPOSED SOLUTION: Effective late 2009, Scottsdale City Court will migrate all outstanding delinquent accounts to the Arizona Supreme Court Fines and Restitution Enforcement (FARE) program. This program includes established performance measures. The FARE program is a statewide mandated collections program for all courts. It has additional collections tools such as the registration hold and release program which puts holds on the defendant's registration/license plate renewal for civil traffic citations that are not paid.

RESPONSIBLE PARTY: Deputy Court Administrator

COMPLETED BY: December 31, 2009

REVENUE RECOVERY

5. Additional delinquent taxes could be collected if previously written off accounts were referred to a collection agency as allowed by City Code.

MANAGEMENT RESPONSE: Management concurs that additional analysis is warranted.

PROPOSED RESOLUTION:

- Management will continue work with the City Attorney's Office to complete cost benefit analysis of sending tax accounts to a collection agency. Staff feels the recovery estimates referenced in this report are greater that the City's experience for the accounts currently being submitted. As such, further analysis is required to make the most cost effective business decision.
- Change the retention period for the write off report from four years to six years to be consistent with the collections recovery period.
- Management will implement all appropriate changes once the analysis is completed.

RESPONSIBLE PARTY: Debora Johnson, Customer Service Director

COMPLETED BY: September 30, 2009

6. The collection agency contract was not updated for 16 years.

MANAGEMENT RESPONSE: Management concurs with this finding.

PROPOSED RESOLUTION: The collection agency contract has been updated and will continue to be maintained as such on an annual basis.

RESPONSIBLE PARTY: Debora Johnson, Customer Service Director

COMPLETED BY: Completed

7. No recent evaluation of alternative service delivery for collection efforts was performed as required by Council approved financial policy.

MANAGEMENT RESPONSE: Management concurs with this finding. Management has had several conversations with our City Attorney's office and other Valley cities as it relates to the matters of passing on the cost of collections to our customers, the possibility of outsourcing services, and forwarding all accounts to our collection agency. We concur that it is important for Customer Service to formalize those discussions and efforts into a document of recommendation on an annual basis.

PROPOSED RESOLUTION: Customer Service will evaluate alternative service delivery systems and make appropriate recommendations.

RESPONSIBLE PARTY: Debora Johnson, Customer Service Director

COMPLETED BY: October 30, 2009

8. The annual write off percentage was not calculated as stated in Council-approved financial policy, and in two instances management was unaware of either the requirement to write off delinquent accounts or that accounts had been written off.

MANAGEMENT RESPONSE: Management concurs with this finding.

PROPOSED RESOLUTION:

- Financial Services' current annual write off memo includes all revenues adjusted for bad debts that are being written off by the Financial Services Department. Financial Services will now include all revenues (City wide) for accounts that have balances being adjusted for bad debt in the annual write off memo.
- Financial Services will develop and implement City wide write off procedures and instructions for City Departments to follow.

RESPONSIBLE PARTY: Debora Johnson, Customer Service Director

COMPLETED BY: June 30, 2009

9. Documented procedures were conflicting, and stated collection activities were not consistently applied.

MANAGEMENT RESPONSE: Management concurs with this finding.

PROPOSED RESOLUTION: Procedures are currently being reviewed and revised to incorporate consistent application of processes and procedures. Manuals will be continuously updated through peer review at regularly scheduled staff meetings. Additional controls will be implemented to ensure compliance.

RESPONSIBLE PARTY: Debora Johnson, Customer Service Director

COMPLETED BY: December 30, 2009

10. Issuance and filing of liens, and assessment of late penalties applicable to delinquent utility accounts, do not comply with Arizona Revised Statutes.

MANAGEMENT RESPONSE:

- 1. Management agrees that Customer Service must annually review State Statutes to ensure compliance.
- 2. Management cannot agree at this time that State Statutes relating to sewer liens apply to Charter Cities; the City's Charter specifically authorizes liens for water, sewer and solid waste fees.
- 3. Management agrees that the lien document title should be updated to reflect the final analysis outcomes.

PROPOSED RESOLUTION:

- 1. Customer Service will continuously review State statutes to ensure we remain compliant with all State code.
- 2. Staff will continue working with the legal department to determine if the State Statute pre-empts the City's Charter regarding the filing of liens for water, sewer and solid waste fees.
- 3. Management will change the lien document title once the interpretation of the State Statute is analyzed.
- 4. Management is already working with our technology team to be ready to implement any changes.

RESPONSIBLE PARTY: Debora Johnson, Customer Service Director

COMPLETED BY: July 31, 2009

11. Lien documents incorrectly stated the amount of interest assessed to the delinquent account.

MANAGEMENT RESPONSE: Management concurs with this finding.

PROPOSED RESOLUTION: All interest assessments were accurate according to State Statute. We have now updated the lien template to display the accurate interest percent.

RESPONSIBLE PARTY: Ruben Hernandez, Customer Service Manager

COMPLETED BY: Completed

12. Late fees are not applied to all delinquent utility accounts as required by City Code.

MANAGEMENT RESPONSE: Management concurs with this finding.

PROPOSED RESOLUTION: Management is currently in the process of revising City code for late fee assessment in our annual rate and fee schedule. The new assessment allows for 1.5 percent of unpaid balances over five dollars with a five dollar minimum charge.

RESPONSIBLE PARTY: Debora Johnson, Customer Service Director

COMPLETED BY: November 1, 2009

13. Reported performance measures were unverifiable and conflicting regarding the dollars collected for every dollar spent.

MANAGEMENT RESPONSE: Management concurs with this finding.

PROPOSED RESOLUTION: Customer Service is currently reviewing and rewriting performance measures for collections.

RESPONSIBLE PARTY: Debora Johnson, Customer Service Director

SCOTTSDALE AIRPORT

14. Management did not sufficiently document procedures applicable to key collection activities.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: While procedures for billing and collection of Airport fees had been documented several years ago, we have taken the opportunity offered by the audit to re-examine and strengthen our policies and procedures. We have drafted robust individual procedures for collection of each type of fee the Airport imposes and as well, have defined criteria for writing off accounts as uncollectible. At the time of audit fieldwork, Airport management was not aware of the annual write-off of accounts, because the policy of the Airport was to continue collection efforts on receivables as aircraft return to the Airport. For that reason, Aviation staff had not defined criteria for uncollectible accounts. The Airport Management Analyst, who is no longer with the City, had reviewed and categorized the recommendations for write off for FY 07/08 Airport receivables without management authorization. Interviews to fill the Management Analyst position as a redeployment due to the City reorganization are scheduled through next week; responsibilities for this activity are a key factor in the hiring process.

In addition, the Aviation Director intends to transition transient landing fee collections to Fixed Base Operators by July 1, 2009, to conform to standard aviation industry business practice. Audit procedures for transient landing fee collections by the Fixed Base Operators have been established for use following the transition.

RESPONSIBLE PARTY: Kim Hanna, Assistant Aviation Director; Scott Gray,

Aviation Director

COMPLETED BY: July 1, 2009

15.Interest was not assessed through the date of final payment as stated in City Code.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: Airport staff has worked with the staff of Financial Services/Accounting on this issue. Financial Services will evaluate modification of the SmartStream Accounts Receivable Module or obtain appropriate approval for the current practice.

RESPONSIBLE PARTY: Richard Chess, Accounting and Tax Audit Director,

Financial Services; Kim Hanna, Assistant Aviation Director

COMPLETED BY: Initial review complete as of February 2009

16. Management did not establish performance measures to assess program performance.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: Airport's business practice is to review aging receivables reports on an on-going basis, and to discuss them monthly with the Airport Advisory Commission. However, we have now developed a quantified performance measure for our billed account types of 90 percent collection by 90 days.

RESPONSIBLE PARTY: Kim Hanna, Assistant Aviation Director

COMPLETED BY: July 1, 2009

APPENDIX A—DELINQUENT ACCOUNTS RECEIVABLE PORTFOLIO ANALYSIS

Due to the unique reporting of each of the three collection programs included in audit, this analysis was limited to available information common to each area. Table 12 is a matrix of various performance measures as suggested by the Credit Research Foundation which specializes in accounts receivable management.

This information is not meant to suggest which performance measures are most valid, rather the purpose is to serve as a reference and provide some level of comparison between the collection programs. No attempt can be made to suggest which program is most successful without knowledge of management's expectations for the program and the amount of resources management is willing to expend for collection efforts.

Table 12. Delinquent Accounts Receivable Portfolio Analysis Scottsdale City Court, Revenue Recovery, and Scottsdale Airport Fiscal Years 06/07 and 07/08

		City Court		Revenue	Recovery	Scottsdale Airport	
		FY 06/07	FY 07/08	FY 06/07	FY 07/08	FY 06/07	FY 07/08
1.	Gross delinquent accounts receivable	\$24.1M	\$28.0M	\$2.8M	\$3.0M	\$92,347	\$63,177
	Gross No. of delinquent accounts	36,524	42,504	19,576	11,309	276	409

This represents a "snap shot" of the delinquent portion of the accounts receivable portfolio as of June 30. It is important to note that each day the portfolio changes; new accounts become delinquent and delinquent accounts are paid.

	Write offs or allowance for						
2.	uncollectibles	(\$15.3M)	(\$18.3M)	(\$1.3M)	(\$1.0M)	(\$5,357)	(\$2,185)
	Net delinquent						
	accounts						
	receivable	\$8.8M	\$9.7M	\$1.5M	\$2.0M	\$86,990	\$60,992

This represents a "snap shot" of the delinquent portion of the accounts receivable portfolio, as of June 30, adjusted to reflect those accounts which have been identified as having a low probability of collection.

	% of gross						
	portfolio older						
3.	than 90 days	96%	97%	69%	84%	5%	4%

This is one indicator of program performance. A lower percentage is favorable. As the age of the accounts receivable portfolio increases the probability of collection decreases.

		City Court		Revenue	Recovery	Scottsdale Airport	
		FY			FY FY		FY
		06/07	07/08	06/07	07/08 5	06/07	07/08
	Program						
4.	FTEs	1.2	1.2	13.5	13.0	0.4	0.4
	Program						
	cost (salary						
	& benefits)	\$62,082	\$63,268	\$879,838	\$878,979	\$19,819	\$20,810

This reflects the number of FTEs and related salary and benefits used to manage, work, and support the respective collection programs. FTE amounts include administrative, management, and system support. The Court and Airport figures are estimates provided by management since collection efforts are only a portion of their overall mission. Because Revenue Recovery's only mission is collections, their amounts are readily identified in budget and SmartStream reports. The Court's low FTE amount is due to their use of a collection agency. Approximately 88 percent of the Court's delinquent accounts are referred to the agency.

•							
	Delinquent			\$12.8M	\$6.2M	amount	amount
	dollars			(taxes	(taxes	not	not
5.	collected	\$2.7M	\$3.3M	only)	only)	available	available

This is one indicator of program performance. A higher amount is favorable provided that management is satisfied with the associated cost expended to collect the funds. The Court amount is based on actual collections by the collection agency. Court funds are also collected internally per Court approved payments plans; however, this amount is not available. The Revenue Recovery amount is applicable to tax collections. These amounts are unaudited and were provided by Revenue Recovery management. There are no existing reports reflecting actual collections of delinquent utility billing and airport fees.

	Delinquent						
	accounts						
	receivable						
6.	per FTE	\$20.1M	\$23.4M	\$210,674	\$229,746	\$230,868	\$157,943
	No. of						
	delinquent						
	accounts						
	per FTE	30,437	35,420	1,450	870	690	1,023

This is one indicator of workload. A high number of delinquent accounts per FTE is favorable provided that management is satisfied with the level of actual collections by staff. The calculated number of accounts worked by Court staff is misleading since most delinquent accounts are worked by the collection agency.

⁵ The Revenue Recovery budget for FY 07/08 included 13 FTEs, each position title is identified on page 10. According to management 5 of these budgeted positions are not exclusively devoted to collection activities: 1 Administrative Secretary, 1 Customer Service Representative, and 3 System Integrators.

	•	City Court		Revenue	Recovery	Scottsdale Airport	
		FY	FY FY		FY	FY	FY
		06/07	07/08	06/07	07/08	06/07	07/08
	Collected						
	by						
	collection						
7.	agency	\$2.7M	\$3.3M	\$4,838	\$18,165	n/a	n/a
	Collection						
	agency self						
	-reported						
	collection						
	rate	27%	31%	60%	26%	n/a	n/a

This is one indicator of program performance. A high amount and percentage is favorable. The amounts reflect reported collections made by the respective collection agencies utilized by the Court and Revenue Recovery. The collection rates reflect the percentage collected on the accounts referred to the agency. These rates are unverified and were self-reported by the agencies.

Annual write						
off or						
designated						
uncollectible	\$3.8M	\$3.0M	\$1.3M	\$1.0M	\$5,357	\$2,185

This is one indicator of program performance. A lower amount is favorable. This reflects the portion of the accounts receivable portfolio written off or deemed uncollectible during the fiscal year.

9.	Total revenues (not necessarily delinquent)	\$13.9M	\$14.4M	\$280.2M	\$335.6M	\$3.8M	\$4.3M
	Annual write offs or uncollectibles as a % of total revenues	27.6%	21.1%	0.5%	0.3%	0.1%	0.1%

This is one indicator of program performance. A lower percentage is favorable. The fiscal year write off or designated uncollectible amount is divided by total applicable revenues.

SOURCE: Auditor analysis of accounts receivable aging reports, the City of Scottsdale Budget Books and SmartStream reports for fiscal years 06/07 and 07/08, approved annual write off memos dated June 25, 2007 and July 1, 2008, revised Court collection reports, and management estimates of FTEs and associated costs provided by Court and Airport management.

City Auditor's Office

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Audit reports are available on the Web site.

This material is available in alternate format upon request.

Audit Committee

Councilman Robert Littlefield, Chairman Vice Mayor Ron McCullagh Councilwoman Suzanne Klapp

City Auditor's Office

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The City Auditor's Office provides independent research, analysis, consultation, and educational services to promote operational efficiency, effectiveness, accountability, and integrity in response to City needs.